



LARGE AND MID-SIZE
BUSINESS DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

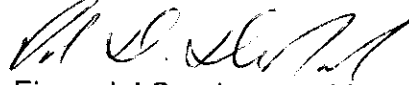
September 8, 2005

MEMORANDUM FOR INDUSTRY DIRECTORS

DIRECTOR, FIELD SPECIALISTS

DIRECTOR, PRE-FILING AND TECHNICAL GUIDANCE

FROM:

Paul D. DeNard 
Industry Director, Financial Services and Issue Champion
Large and Mid-Size Business Division

SUBJECT:

Industry Directive on Treatment of Original Issue Discount
Income, the Accommodation Fee, and Transaction Costs in
Sale-In/Lease-Out (SILO) Transactions

Overview

The SILO Coordinated Issue Paper (CIP), effective June 29, 2005, concludes that taxpayers participating in these transactions: (1) are not entitled to currently deduct depreciation (including depreciation of the Accommodation Fee) under I.R.C. § 168 because the taxpayer does not acquire and retain significant and genuine attributes of a traditional owner, including the benefits and burdens of ownership of the property and because all or a portion of the taxpayer's Equity Investment is a financing arrangement rather than a true sale-leaseback; (2) generally are not entitled to currently amortize Transaction Costs resulting from their participation in the transaction under I.R.C. § 162; (3) are not entitled to deduct interest expense under I.R.C. § 163 as no amount is paid for the use or forbearance of money; and, (4) are liable for the accuracy-related penalty under I.R.C. § 6662 in taxable years ended on or before October 22, 2004 if the taxpayer is unable to establish reasonable cause and good faith under I.R.C. § 6664(c)(1) and the pertinent regulations.

The CIP further states that the taxpayer can be viewed as the lender in a financing transaction. The amount of the 'deemed loan' from the taxpayer to the Tax Exempt Entity will equal the Equity Collateral, that is, the amount of the Equity Investment set aside by the Tax Exempt Entity to purchase the highly-rated securities that establish the Equity Defeasance. The Equity Collateral typically equals the Equity Investment less the Accommodation Fee. Accordingly, as a lender, the taxpayer must recognize unreported taxable original interest discount (OID) income and the calculation of OID will be based only on the Equity Collateral.

Moreover, per the CIP, the taxpayer may, under certain limited circumstances, be entitled to amortize the Transaction Costs and Accommodation Fee. However, amortization will be available only in instances where the taxpayer can prove these costs and/or fee are allocable to the “deemed loan”. Until the taxpayer provides evidence of such allocation, these costs and fee should continue to be disallowed.

Some audit teams issued NOPAs/Forms 5701 and RARs disallowing the referenced deductions and costs related to SILO transactions prior to the June 29, 2005 effective date of the CIP. Thus, those NOPAs/Forms 5701 may not have provided the taxpayer with complete notice of the legal arguments and positions contained in the CIP. Specifically, those NOPAs/Forms 5701 and RARs may not have asserted OID since the taxpayer is considered a lender, provided the amount of the unreported taxable OID, and included an adjustment for the allowable amortization, if any, of the Accommodation Fee and Transaction Costs under the circumstances stated in the CIP.

To ensure that taxpayers are fully informed of the Service’s position on asserting OID, the amount of unreported taxable OID, and the circumstances under which the Accommodation Fee and Transaction Costs may be allowable, it is critical that audit teams take the following steps, depending on their circumstances as described below:

1. Where the case has been entered into the Appeals Division database and is thus under Appeals jurisdiction, the audit team need **not** revise or reissue the NOPA/Form 5701/RAR or take any other action to assert OID income or provide the taxpayer with an opportunity to demonstrate it is entitled to any amortization of the Accommodation Fee or Transaction Costs.
2. If the audit team issued a NOPA/Form 5701 and the RAR prior to June 29, 2005 but the case is not yet in Appeals jurisdiction, the team should issue the pro forma letter to the taxpayer. That letter will advise the taxpayer of the Service’s position as stated in the CIP and as noted above. The audit team will also need to attach to the letter a revised OID calculation for each lease using the new OID spreadsheet. There will be **no need** to revise or reissue the NOPA/Form 5701/RAR. If the case is still in Exam’s jurisdiction, a copy of the letter and the OID calculation should be placed in the file. If the case is on its way to Appeals, the information should be forwarded to Appeals to associate with the case file.
3. If the audit team has issued a NOPA/Form 5701 but not the RAR, the letter should be issued to the taxpayer with the revised OID calculation. The NOPA will **not** need to be revised or reissued. However, the RAR/Form 4549 should include the OID amount as an adjustment to income by taxable year for the years within the audit cycle. The OID spreadsheet calculation will also provide the taxpayer with the anticipated OID adjustment in years subsequent to the current audit cycle.

4. If the audit team has substantially completed their NOPA/Form 5701, but has not issued it to the taxpayer, they should revise the NOPA/Form 5701 to include OID and the circumstances under which the Accommodation Fee and Transaction Costs may be amortizable and provide the taxpayer with the revised OID calculation. The pro forma letter will **not** need to be issued to the taxpayer. The RAR should include the OID amount as an adjustment to income by taxable year for the years within the audit cycle. The OID spreadsheet calculation will also provide the taxpayer with the anticipated OID adjustment in years subsequent to the current audit cycle. Audit teams in this situation should use their discretion in determining whether revising the NOPA/Form 5701 to include the OID and information on the Accommodation Fee and Transaction Costs will delay meeting the ECD.

5. If the audit team has not begun writing a NOPA/Form 5701 or has not substantially completed a NOPA/Form 5701, they must use the revised NOPA/Form 5701 that will be consistent with the SILO CIP as soon as it is available on the Leasing Technical website. The NOPA/Form 5701 is currently being revised and audit teams will be notified when the revised NOPA/Form 5701 is available for their use. The pro forma letter will **not** need to be issued to the taxpayer.

6. If multiple NOPAs/Forms 5701 were issued, the team should issue one pro forma letter with an attachment listing the date each SILO NOPA/Form 5701 was issued, the name of the Tax Exempt Entity participating in each SILO transaction, and the amount of the OID income asserted for each SILO lease by taxable year for the years within the audit cycle.

Once the pro forma letter, the revised OID calculation spreadsheet, and the revised NOPA/Form 5701 consistent with the SILO CIP are available, these documents may be accessed on the internet at the hyperlink shown here:

<http://lmsb.irs.gov/hq/pftg/leasing/SILO.asp>

The Technical Advisors will answer any questions on the OID spreadsheet, when an audit team should issue the pro forma letter, when the Accommodation Fee and/or Transaction Costs may be amortizable, and when the NOPA/Form 5701 will need revision. In addition, all audit teams should contact their local counsel with any questions on the SILO CIP position and this Industry Directive. This LMSB Directive is not an official pronouncement of the law and cannot be used, cited, or relied upon as such.

For additional information or assistance with SILOs or other leasing transactions, please contact the Leasing Technical Advisors listed below or your local counsel.

<u>Technical Advisor</u>	<u>Phone Number</u>	<u>E-mail address</u>
Patricia Autry	704-566-5363	Patricia.Autry@irs.gov
Amy Liberator	330-253-7341	Amy.Liberator@irs.gov
Bob Snyder	806-359-2165	Robert.Snyder@irs.gov

cc: Commissioner and Deputy Commissioner (LMSB)